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# REPORT TO THE CONGRESS



~~74-0274~~  
095862

Audit Of Federal Deposit  
Insurance Corporation For  
The Year Ended June 30, 1973  
Limited By Agency Restriction On  
Access To Bank Examination  
Records

B-114831

*BY THE COMPTROLLER GENERAL  
OF THE UNITED STATES*

~~702075~~ / 095862 MAY 23, 1974



COMPTROLLER GENERAL OF THE UNITED STATES  
WASHINGTON, D.C. 20548

B-114831

To the President of the Senate and the  
Speaker of the House of Representatives

This is our report on the audit of the Federal Deposit Insurance Corporation for the year ended June 30, 1973. 195

We made our examination pursuant to section 17(c) of the Federal Deposit Insurance Act (12 U.S.C. 1827).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of the Treasury; and the Chairman of the Board of Directors, Federal Deposit Insurance Corporation.

A handwritten signature in cursive script, appearing to read "A. M. Kellum".

Acting Comptroller General  
of the United States

C o n t e n t s

	<u>Page</u>
DIGEST	1
CHAPTER	
1 INTRODUCTION	3
Examinations of insured banks	3
President's recommendations for improv- ing the U.S. financial system	4
2 CONTINUED RESTRICTION ON ACCESS TO REPORTS AND RECORDS ON BANK EXAMINATIONS	6
Agency comments	6
Matters for consideration by the Congress	9
3 PROBLEM BANKS AND BANK FAILURES	10
Problem banks	10
Bank failures	11
Closing of U.S. National Bank of San Diego	12
Estimated liability for future bank failures	13
4 STATUS OF PRIOR YEARS' RECOMMENDATION	14
5 SCOPE OF AUDIT	15
6 OPINION ON FINANCIAL STATEMENTS	16
FINANCIAL STATEMENTS	
Schedule	
1 Comparative statement of financial condi- tion, June 30, 1973, and June 30, 1972	17
2 Comparative statement of income and deposit insurance fund, fiscal years ended June 30, 1973, and June 30, 1972	18
3 Statement of changes in financial position, fiscal year ended June 30, 1973	19
4 Analysis of deposit insurance fund from inception to June 30, 1973	20
Federal Deposit Insurance Corporation footnotes to the financial statements	21
GAO note to financial statements	22

APPENDIX

Page

I	Letter dated March 4, 1974, from the Federal Deposit Insurance Corporation to the General Accounting Office	23
II	Membership of the Board of Directors	29

D I G E S T

WHY THE AUDIT WAS MADE

The Federal Deposit Insurance Act requires the Comptroller General to annually audit the Corporation.

OPINION ON FINANCIAL STATEMENTS

The Corporation's financial statements do not show an estimate of the liability which the Corporation will incur because of future bank failures.

As in prior years, GAO did not have unrestricted access to bank examination reports and related documentation. Therefore, GAO could not ascertain (1) whether bank examinations were of sufficient scope and reliability to identify all the banks that should have been classified as problem banks, (2) whether the Corporation had taken effective followup action on bank examiners' findings, and (3) the significance of any possible adverse effects of problem banks on the Corporation's financial position.

For these reasons GAO cannot express an overall opinion on the accompanying financial statements for fiscal year 1973. GAO believes that, except for the estimated liability for future bank failures commented on above, the individual amounts shown in the financial statements are fairly stated as of June 30, 1973, and for the fiscal year then ended, in conformity with generally accepted

accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws.

OTHER MATTERS OF INTEREST

GAO could not fully discharge its audit responsibilities because the Corporation would not permit GAO unrestricted access to examination reports, files, and other records related to insured banks. GAO believes that access to these records is essential because they contain facts, opinions, and recommendations of vital importance to the conduct of the Corporation's affairs.

The Corporation believes that the basic concept of confidentiality, regarding open bank data, is essential for proper supervision and functioning of banks.

The Corporation believes further that GAO should not have general access to examination reports and records and that the Corporation's contingent liability cannot be equated with problem banks. (See pp. 6 to 9.)

On October 18, 1973, the Comptroller of the Currency closed the U.S. National Bank, San Diego, California, and appointed the Corporation receiver. U.S. National, which was the largest bank to close in the history of the United States, had over

\$1.2 billion in assets and approximately \$932 million in deposits. According to Corporation estimates, about \$461 million of these deposits were insured, about \$242 million of the deposits were secured by assets of the bank, and about \$229 million of the deposits were uninsured.

The Crocker National Bank of San Francisco took over the acceptable assets and substantially all the liabilities of U.S. National; the remainder was acquired by the receiver. The Corporation has established a reserve for loss of \$48.3 million in connection with this closing. (See pp. 12 and 13.)

In prior audit reports to the Congress on the Corporation, GAO recommended that the Federal Deposit Insurance Act be amended to require that the Corporation reimburse the employees' compensation fund for benefit payments made after the creation of the Corporation.

The Chairman of the Board of Directors told GAO the Corporation had a

legal basis for reimbursing the fund and planned to repay the compensation benefits which have inured to its employees and also to pay these costs in the future. (See p. 7.)

RECOMMENDATIONS OR SUGGESTIONS

This report contains no recommendations to officials of the Corporation.

AGENCY ACTIONS AND UNRESOLVED ISSUES

Both the Corporation and GAO believe that the law supports their respective positions on the access-to-records problem. Repeated efforts to resolve the matter administratively have failed.

MATTERS FOR CONSIDERATION  
BY THE CONGRESS

GAO recommends that the Congress amend the Federal Deposit Insurance Act to clarify GAO's authority to have access to examination reports, files, and other records used by the Corporation. (See p. 9.)

## CHAPTER 1

### INTRODUCTION

The Federal Deposit Insurance Corporation is an independent Government agency which insures deposits in qualified banks to a maximum of \$20,000 for each depositor. National banks which are chartered by the Comptroller of the Currency and all State banks which are members of the Federal Reserve System are required to be insured. State banks which are not members of the Federal Reserve System may become insured upon the approval of their application.

The Corporation also acts, when appointed to do so, as receiver for insured banks that have been closed. At June 30, 1973, the Corporation had 28 active receivership cases.

The Corporation finances its operations from assessments against insured banks and from its investments in U.S. Government securities. The deposit insurance fund, representing the accumulated net income, totaled \$5.4 billion at June 30, 1973. This amount was 1.24 percent of the insured deposits of \$435.3 billion in the 14,178 insured banks at June 30, 1973. The Corporation can borrow up to \$3 billion from the U.S. Treasury when, in the judgment of the Board of Directors, such funds are required for insurance purposes. The Corporation has never used this borrowing authority.

Management of the Corporation is vested in the Board of Directors, composed of (1) two members appointed by the President of the United States by and with the advice and consent of the Senate and (2) the Comptroller of the Currency. The board members are listed in appendix II. (See p. 30.)

### EXAMINATIONS OF INSURED BANKS

The Corporation periodically examines insured State banks which are not members of the Federal Reserve System. The Federal Reserve banks examine State member banks, and the Comptroller of the Currency examines national banks. The Corporation has access to their examination reports.

At June 30, 1973, the Corporation insured 8,471 State nonmember, 1,076 State member, and 4,631 national banks. The Corporation reported that, during fiscal year 1973, it had examined 7,948 insured State nonmember banks and had reviewed examination reports on 208 State member banks and 677 national banks.

PRESIDENT'S RECOMMENDATIONS FOR IMPROVING  
THE U.S. FINANCIAL SYSTEM

In an August 1973 message to the Congress, the President recommended legislation to improve and strengthen the financial system of the United States. These recommendations were designed to (1) increase competition among commercial banks and thrift institutions and (2) promote adequate funds for consumer needs, including housing finance.

Because mutual savings banks, a category of thrift institutions, and commercial banks are either insured by, or eligible to be insured by, the Corporation, we asked its view on the proposed legislation. The Corporation told us that, generally speaking, it supported the basic purpose of the administration's proposals. It added that, although many of the proposals were controversial, it believed they were basically sound. The remainder of this section summarizes the major areas in which the proposals would affect commercial banks and thrift institutions.

The President recommended legislation in the following major areas, to increase competition among commercial banks and thrift institutions.

1. Interest ceilings on time and savings deposits should be eliminated over a 5-1/2 year period.
2. Expanded deposit services for consumers by federally chartered thrift institutions and banks should be allowed.
3. Investment and lending alternatives for federally chartered thrift institutions and banks should be expanded.
4. Federal charters for stock savings and loan institutions and mutual savings banks should be permitted.

The President stated that increased competition would help to eliminate the inequities now imposed upon the small saver and buyer by reducing the cost of financial services and ensuring a fair return on savings.

The President also recommended legislation in the following major areas, which, with the legislation previously mentioned, is intended to provide adequate funds for consumer needs, including housing finance.

1. Federal Housing Administration and Veterans Administration interest ceilings should be removed.
2. The tax structure of banks and thrift institutions should be modified to provide them with a uniform tax formula.

The administration believes the adoption of these recommendations would remove the barriers to financing resulting from interest ceilings and would substantially broaden the base of housing finance.

## CHAPTER 2

### CONTINUED RESTRICTION ON ACCESS TO REPORTS

#### AND RECORDS ON BANK EXAMINATIONS

As in prior years, we could not fully discharge our audit responsibilities under the Federal Deposit Insurance Act because Corporation officials did not give us unrestricted access to examination reports, files, and other records relating to insured banks, except for the records of closed banks.

Access to the records of the Corporation's Division of Bank Supervision is essential to a meaningful audit of the Corporation. The Division employs about 76 percent of the Corporation's total personnel, and the Division's efforts and reports are an essential and integral part of the Corporation's operations. The reports on insured banks contain facts, opinions, and recommendations of vital importance to the conduct of the Corporation's affairs. Without unrestricted access to these reports and the supporting documentation, we cannot evaluate important information affecting the Corporation's financial operations and condition.

Because of the restrictions the Corporation imposed, we were unable to ascertain (1) whether bank examinations were of sufficient scope and reliability to identify all the banks that should have been classified as problem banks, (2) whether the Corporation had taken effective followup action on bank examiners' findings, and (3) the significance of any possible adverse effects of problem banks on the Corporation's financial position.

GAO's and the Corporation's positions on this matter are set forth in detail in our report to the Congress "Audit of the Federal Deposit Insurance Corporation for the Fiscal Year Ended June 30, 1964" (B-114831, Feb. 28, 1966).

#### AGENCY COMMENTS

In the Corporation's comments of March 4, 1974, on our 1973 report, the Chairman said that we should not have had general access to the examination reports and records because we had been given sufficient information to discharge our audit responsibility. The Chairman stated that:

"While the Corporation has consistently refused GAO's request in recent years for general access to reports of examination of open banks and to related material which disclose the name of the bank involved,

we do provide significant information to GAO about problem banks and other insured banks \* \* \*.

"and \* \* \* FDIC [Federal Deposit Insurance Corporation] furnish[es] GAO's auditors each year with copies of recapitulations of serious problem banks and other problem banks, arranged by states and by totals, accompanied by a brief code analysis of the problems in each bank; that GAO's auditors could designate a number of such banks for selective review purposes; that FDIC, by code identification and without divulging the names of these banks, would discuss with GAO's auditors pertinent matters pertaining to the State nonmember banks included in the sample, including the relevant reports of examination and correspondence file; that FDIC would certify that the information given accurately reflected the confidential examination reports and file material related to such bank; that the same code identification given each bank reviewed would be continued until the bank reviewed was removed from the problem list; that similar information with respect to examination reports of open banks not classified as problem banks would be handled generally in the same manner; and that with regard to closed banks, GAO's auditors would have free access to all examination reports and related documents in our possession."

We are required to review the Corporation's activities, including the effectiveness of bank supervision. Our responsibility is to provide the Congress with an informed and impartial opinion on the Corporation's operations and financial condition. To form such an opinion, we must have access to all pertinent information, including examination reports and records. If we have access to only such information as the Corporation chooses to provide, we cannot reach an informed and impartial opinion.

As we have indicated in the past, there is no need for disclosing the identity of any bank or group of banks. We believe that, even though the name of the bank is withheld, it is imperative that we review the actual records and reports. Relying on discussion of the contents of these documents is not an acceptable alternative.

On another issue the Chairman stated that:

"\* \* \* We continue to feel that the information contained in these reports of examination and related material must be regarded as confidential.

We repeat our view, stated on numerous occasions in the past, that GAO's general access to this material, by name of bank, would be contrary to the public interest in the effective supervision of insured banks and the effective functioning of the Corporation's program of deposit insurance."

GAO concurs with the need for confidentiality. As in the past, our position is that the information provided will be treated in confidence.

A third point raised by the Chairman was that the Corporation's contingent liability could not be equated with problem banks. He stated that:

"While it is clear that our contingent liability for possible future expenditures from the Federal deposit insurance fund cannot be predetermined with regard to banks on our 'problem' list, any attempt to estimate such liability on the basis of a general review of examination reports and related material on all open banks would erode the fundamental concept of deposit insurance: that is, the maintenance of public confidence in our banking system."

Since 1934 at least one bank has been closed each year, which has resulted in a financial outlay by the Corporation. The fact that banks which are not on the Corporation's problem list, have been closed serves to strengthen our view that we should have access to the examination records on all banks. This notwithstanding, we believe that any financial statement the Corporation issued that does not reveal at least a reasonable estimate of expenditures which will result from future bank closings does not fully disclose the Corporation's financial position.

The estimated liability, in our opinion, should be derived from (1) past bank failures and (2) the banks on the Corporation's problem list. The Corporation defines a "serious problem-potential payoff bank" as one considered to have at least a 50-percent chance of requiring financial assistance from the Corporation in the near future. The Corporation defines a "serious problem bank" as one which threatens ultimately to involve the Corporation in a financial outlay unless a drastic change can be made. Therefore we believe that the Corporation should show on its financial statements an estimate of the liability which it will incur because of future bank failures.

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Both the Corporation and GAO believe the present law supports their respective positions on the access-to-records problem. Repeated efforts to resolve this matter administratively have failed.

MATTERS FOR CONSIDERATION BY THE CONGRESS

To more effectively carry out our audit responsibility, we recommend that the Congress amend the Federal Deposit Insurance Act to clarify our authority to have access to examination reports, files, and other records of the Corporation, the Federal Reserve banks, and the Comptroller of the Currency.

For this purpose the third sentence of section 17(b) of the act (12 U.S.C. 1827(b)) should be amended to read as follows:

"The representatives of the General Accounting Office shall have access to all books, accounts, records, reports, files, and all other papers, things, or property belonging to or in use by the Corporation pertaining to its accounts and operations and necessary to facilitate the audit, including bank examination reports and related records, and they shall be afforded full facilities for verifying transactions with the balances or securities held by depositaries, fiscal agents, and custodians." (Underscoring denotes the change required.)

CHAPTER 3

PROBLEM BANKS AND BANK FAILURES

PROBLEM BANKS

The Corporation classifies problem banks as serious problem-potential payoff banks, serious problem banks, and other problem banks. It defines a "serious problem-potential payoff bank" as one considered to have at least a 50-percent chance of requiring financial assistance from the Corporation in the near future. It defines a "serious problem bank" as one which threatens ultimately to involve the Corporation in a financial outlay unless a drastic change can be made. It defines an "other problem bank" as one which is less vulnerable and requires aggressive supervision.

The Corporation's estimate of the number of problem banks and the estimated insured deposits at June 30, 1973 and 1972, are shown below.

	<u>Number of banks</u>		<u>Estimated insured deposits</u>	
	<u>June 30,</u> <u>1973</u>	<u>June 30,</u> <u>1972</u>	<u>June 30,</u> <u>1973</u>	<u>June 30,</u> <u>1972</u>
			(000 omitted)	
Serious problem-potential payoff banks:				
State nonmember banks	2	8	\$ 16,474	\$ 37,057
State member banks	1	2	8,095	12,475
National banks	<u>a2</u>	<u>3</u>	<u>a449,991</u>	<u>29,037</u>
Total	<u>5</u>	<u>13</u>	<u>474,560</u>	<u>78,569</u>
Serious-problem banks:				
State nonmember banks	16	17	124,366	140,899
State member banks	3	5	103,511	951,866
National banks	<u>5</u>	<u>7</u>	<u>56,760</u>	<u>87,091</u>
Total	<u>24</u>	<u>29</u>	<u>284,637</u>	<u>1,179,856</u>
Other problem banks:				
State nonmember banks	101	133	1,409,665	1,504,086
State member banks	9	8	833,534	102,426
National banks	<u>20</u>	<u>35</u>	<u>201,548</u>	<u>611,809</u>
Total	<u>130</u>	<u>176</u>	<u>2,444,747</u>	<u>2,218,321</u>
Total	<u>159</u>	<u>218</u>	<u>\$3,203,944</u>	<u>\$3,476,746</u>

<sup>a</sup>Approximately \$1.6 million was held by a small national bank; the balance was the estimated insured deposits of the U.S. National Bank of San Diego which was closed on October 18, 1973.

During fiscal year 1973, the Corporation removed 156 banks from the problem-bank classification--154 because of improvements in bank management and/or financial condition and 2 because of bank failure--and added 97 other banks, making a total of 159 problem banks at June 30, 1973. The Corporation estimated the five largest problem banks had insured deposits which totaled \$1.6 billion.

To correct problem conditions at an insured bank, the Corporation and the appropriate bank regulatory body--the Comptroller of the Currency, the Federal Reserve Board, or the State banking authority--attempt to obtain the bank management's cooperation. When it cannot obtain corrective action by this method, the Corporation is authorized to take corrective measures, subject to certain protective standards and procedures. Under this authority the Corporation issued 12 cease-and-desist orders to insured banks engaged in unsafe and unsound practices and approved 4 notices of intention to remove or suspend bank officials.

When unsafe and unsound practices persist, the Corporation is authorized to initiate proceedings which may result in terminating the bank's deposit insurance coverage. The Corporation initiated three such proceedings during fiscal year 1973.

When an insured bank is in danger of closing, the Corporation is authorized, under section 13(c) of the Federal Deposit Insurance Act, to make loans to the bank when the bank's continued operation is essential to provide adequate banking service to the community. Under this authority the Corporation had \$37 million in outstanding loans as of June 30, 1973. Furthermore, the Board of Directors had authorized \$24.5 million additional in loans to one bank, if needed.

#### BANK FAILURES

During fiscal years 1969-73, 27 insured banks failed, as shown below.

<u>Fiscal year</u>	<u>Number of insured banks which failed</u>			
	<u>Total</u>	<u>State</u>		<u>National</u>
		<u>Nonmember</u>	<u>Member</u>	
1969	6	3	2	1
1970	7	5	-	2
1971	8	7	-	1
1972	3	2	-	1
1973	<u>3</u>	<u>2</u>	<u>-</u>	<u>1</u>
Total	<u>27</u>	<u>19</u>	<u>2</u>	<u>6</u>

The Corporation estimated that, for the three banks which failed during fiscal year 1973, the insured deposits totaled about \$8.8 million and that its losses at June 30, 1973, were about \$1.5 million.

<u>Bank</u>	<u>Date closed</u>	<u>Estimated insured deposits</u>	<u>Estimated loss to Corporation</u>
(000 omitted)			
Delta Security Bank and Trust Company, Ferriday, Louisiana	1-19-73	\$4,282	\$ 800
Skyline National Bank, Denver, Colorado	3-25-73	1,904	293
Elm Creek State Bank, Elm Creek, Nebraska	5- 7-73	<u>2,571</u>	<u>400</u>
		<u>\$8,757</u>	<u>\$1,493</u>

The Corporation, in discharging its insurance indemnity liability for the three banks, began to pay the depositors of two of the banks the amounts of their insured deposits and took action to facilitate another insured bank's acquiring the third bank within a few days after its closing. As of June 30, 1973, over 93 percent of the insured deposits in the Delta Security Bank and Trust Company and the Elm Creek State Bank had been paid. On April 2, 1973, the United Bank of Skyline, National Association, Denver, purchased certain assets and assumed the deposit liabilities of the Skyline National Bank.

#### Closing of U.S. National Bank of San Diego

On October 18, 1973, the Comptroller of the Currency closed the U.S. National Bank, San Diego, California, and appointed the Corporation receiver. On the same day, the Crocker National Bank of San Francisco assumed substantially all the deposit liabilities and purchased the acceptable assets of the closed bank. In addition, it paid a \$89.5 million premium to the Corporation in closing this transaction.

U.S. National, which was the largest bank to close in the history of the United States, had assets worth over \$1.2 billion and deposits of approximately \$932 million. Of those deposits, according to Corporation estimates, about \$461 million were insured, about \$242 million were secured by bank assets, and about \$229 million were uninsured.

The Corporation, as receiver, purchased the U.S. National's unacceptable assets having a total book value of \$412 million. The Corporation paid the Crocker National Bank \$130 million, and paid the Federal Reserve Bank of San Francisco \$30 million as consideration for releasing assets pledged by U.S. National. In addition, the Corporation assumed liabilities of \$117 million and the \$49 million capital account of the closed bank. The Corporation purchased a \$50 million note from Crocker National Corporation to provide the Crocker National Bank with additional capital.

The Corporation has established a \$48.3 million reserve for loss in connection with this closing. A measure of the significance of the estimated loss can be seen by contrasting it with the total net losses of \$76.4 million incurred since the fund's inception through June 30, 1973.

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The Corporation's records show the bank failures in the last several years had resulted from various combinations of unsound and deceptive practices in operations, including misuse of bank funds by bank officers, directors, and owners; substandard loans and excessive appraisals of collateral; unwarranted loans in which bank officials, directors, and owners had personal financial interests; loans in excess of the limits prescribed by law; broker-solicited funds in certificates of deposit and related, unwarranted out-of-territory lending; inadequate capital; unsatisfactory management; and defalcations.

#### Estimated liability for future bank failures

The Corporation's financial statements do not show an estimate of the liability which the Corporation will incur from future failures of insured banks. The Corporation recognizes losses resulting from bank failures in the period in which they are incurred. This policy is contrary to generally accepted accounting principles which advocate matching expenses to the periods in which the revenues are recognized.

This matter has been discussed in GAO's prior years' reports on the financial operations of the Corporation.

## CHAPTER 4

### STATUS OF PRIOR YEARS' RECOMMENDATION

In our prior audit reports, we recommended that the Federal Deposit Insurance Act be amended to require the Corporation to pay into the employees' compensation fund the amount of benefit payments made from that fund on account of the Corporation's employees for all periods after the creation of the Corporation.

In his March 4, 1974, letter, the Chairman said that:

"For several years, based upon somewhat institutional views and prior interpretations, the Corporation has supported GAO's recommendation that the Federal Deposit Insurance Act be amended \* \* \* [to] reimburse the employees' compensation fund for benefit payments made after the creation of the Corporation.

"In the past year we have reviewed and researched these situations carefully. On the basis of discussions with individuals in GAO and in the Civil Service Commission, \* \* \*.

"\* \* \* we have concluded that we can find a legal basis, notwithstanding earlier interpretations, for reimbursing the employees' compensation fund for benefit payments made after the creation of the Corporation and more recently. The latter conclusion will permit us to repay any compensation benefits which have inured to our employees and will also permit us to pay such costs in the future."

The Chairman's actions should resolve those matters concerning the reimbursement of the employees' compensation fund.

## CHAPTER 5

### SCOPE OF AUDIT

We have examined the statement of financial condition of the Federal Deposit Insurance Corporation as of June 30, 1973, the related statements of income and deposit insurance fund and of changes in financial position for the year then ended, and the statement of analysis of the deposit insurance fund from the fund's inception. Our examination was made in accordance with generally accepted auditing standards and, with the exception concerning review of bank examination reports and related data which is discussed in chapter 2 (see p. 6), included such tests of the accounting records and such other auditing procedures as we considered necessary.

## CHAPTER 6

### OPINION ON FINANCIAL STATEMENTS

The Corporation prepared the financial statements in this report. These financial statements do not show an estimate of the liability which the Corporation may incur because of future bank closings.

Because we did not have unrestricted access to examination reports and related documentation on insured banks (see p. 6), we could not ascertain (1) whether bank examinations were of sufficient scope and reliability to identify all the banks that should have been classified as problem banks, (2) whether the Corporation had taken effective followup action on bank examiners' findings, and (3) the significance of any possible adverse effects of problem banks on the Corporation's financial position.

For these reasons we cannot express an overall opinion on the accompanying financial statements for fiscal year 1973. In our opinion, except for the estimated liability for future bank failures, commented on above, the individual amounts shown in the financial statements are fairly stated as of June 30, 1973, and for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year and with applicable Federal laws.

SCHEDULE 1

FEDERAL DEPOSIT INSURANCE CORPORATION  
 COMPARATIVE STATEMENT OF FINANCIAL CONDITION  
 JUNE 30, 1973, AND JUNE 30, 1972

	<u>June 30, 1973</u>		<u>June 30, 1972</u>
	(000 omitted)		
ASSETS			
CASH	\$ 7,372		\$ 6,516
U.S. GOVERNMENT OBLIGATIONS:			
Securities at amortized cost (note a)	\$5,632,899		\$5,088,253
Accrued interest receivable	<u>82,094</u>	5,714,993	<u>66,658</u>
ASSETS ACQUIRED IN RECEIVERSHIP AND DEPOSIT ASSUMPTION TRANSACTIONS:			
Special assistance to insured banks	-		6,244
Subrogated claims of depositors against closed insured banks	75,045		93,945
Net insured balances of depositors in closed insured banks, to be subrogated when paid, see related liability	1,137		1,838
Equity in assets acquired under agreements with insured banks	28,100		81,542
Assets purchased outright	<u>4,964</u>		<u>16</u>
	109,246		183,585
Less reserves for losses	<u>40,586</u>	68,660	<u>42,193</u>
ASSTANCE TO OPERATING INSURED BANKS:			
Principal	37,000		18,000
Accrued interest receivable	<u>487</u>	37,487	<u>-</u>
LAND AND OFFICE BUILDING, less depreciation on building		7,026	7,162
MISCELLANEOUS ASSETS		<u>957</u>	<u>604</u>
Total assets		<u>\$5,836,495</u>	<u>\$5,328,585</u>
LIABILITIES AND DEPOSIT INSURANCE FUND			
ACCOUNTS PAYABLE AND ACCRUED LIABILITIES	\$ 3,798		\$ 3,456
EARNEST MONEY, ESCROW FUNDS AND COLLECTIONS HELD FOR OTHERS		1,099	2,148
ACCRUED ANNUAL LEAVE OF EMPLOYEES		3,259	3,000
DUE INSURED BANKS:			
Net assessment income credits:			
Available July 1, 1972	\$ -		\$ 241,359
Available July 1, 1973	280,247		135,307
Available July 1, 1974 (estimated)	153,869		-
Other	<u>80</u>	434,196	<u>57</u>
NET INSURED BALANCES OF DEPOSITORS IN CLOSED INSURED BANKS--See related asset		<u>1,137</u>	<u>1,838</u>
Total liabilities		443,489	387,165
DEPOSIT INSURANCE FUND, net income accumulated since inception (sch. 2)		<u>5,393,006</u>	<u>4,941,420</u>
Total liabilities and deposit insurance fund		<u>\$5,836,495</u>	<u>\$5,328,585</u>

<sup>a</sup>The securities had a face value of \$5,635,829,000, cost of \$5,615,656,000, and market value of \$5,306,270,000 at June 30, 1973.

The notes following schedule 4 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements is set forth on page 16.

BEST DOCUMENT AVAILABLE

SCHEDULE 2

FEDERAL DEPOSIT INSURANCE CORPORATION  
 COMPARATIVE STATEMENT OF INCOME AND DEPOSIT INSURANCE FUND  
 FISCAL YEARS ENDED JUNE 30, 1973, AND JUNE 30, 1972

	<u>Fiscal Year 1973</u>		<u>Fiscal Year 1972</u>
	(000 omitted)		
INCOME:			
Deposit insurance assessments:			
Assessments earned during the year	\$499,853		\$444,949
Less net assessment income credits to insured banks--estimated	<u>298,824</u>	\$ 201,029	<u>272,964</u> \$ 171,985
Adjustments of assessments earned in prior years		<u>91</u>	<u>96</u>
		201,120	172,081
Net income from U.S. Government securities		299,713	256,277
Other income		<u>2,408</u>	<u>887</u>
Total income		<u>503,241</u>	<u>429,245</u>
EXPENSES AND LOSSES:			
Administrative and operating expenses		51,300	48,895
Provision for insurance losses:			
Applicable to banks assisted in the current fiscal year	6,000		6,500
Adjustments applicable to banks assisted in prior years	<u>-6,630</u>	-630	<u>-14,207</u>
Nonrecoverable insurance expenses incurred to protect depositors--net		<u>985</u>	<u>824</u>
Total expenses and losses		<u>51,655</u>	<u>35,512</u>
NET INCOME--ADDITION TO THE DEPOSIT INSURANCE FUND FOR THE YEAR		451,586	393,733
DEPOSIT INSURANCE FUND, at the beginning of the year		<u>4,941,420</u>	<u>4,547,687</u>
DEPOSIT INSURANCE FUND, at the end of the year--net income accumulated since inception		<u>\$5,393,006</u>	<u>\$4,941,420</u>

The notes following schedule 4 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements is set forth on page 16.

FEDERAL DEPOSIT INSURANCE CORPORATION  
 STATEMENT OF CHANGES IN FINANCIAL POSITION  
 FISCAL YEAR ENDED JUNE 30, 1973

	<u>Amount</u> (in thousands)
FUNDS PROVIDED BY:	
Net deposit insurance assessments	\$ 201,120
Income from U.S. Government securities, less amortized net discounts	297,875
Maturities and sales of U.S. Government securities, including exchanges of long term securities	960,971
Collections on assets acquired in receiv- ership and deposit assumption transac- tions	86,840
Increase in assessment credits due insured banks	<u>57,474</u>
Total funds provided	<u>\$1,604,280</u>
FUNDS APPLIED TO:	
Administrative, operating and insurance expenses, less miscellaneous credits	\$ 49,742
Acquisition of assets in receivership and deposit assumption transactions	14,179
Purchase of U.S. Government securities, including exchanges of long term securities	1,503,779
Net changes in other assets and liabil- ities	<u>36,580</u>
Total funds applied	<u>\$1,604,280</u>

The notes following schedule 4 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements is set forth on page 16:

SCHEDULE 4

FEDERAL DEPOSIT INSURANCE CORPORATION  
 ANALYSIS OF DEPOSIT INSURANCE FUND  
 FROM INCEPTION TO JUNE 30, 1973

	<u>Amount</u>
	(in thousands)
INCOME:	
Insurance assessments	\$6,596,641
Less net assessment income credits	<u>3,278,269</u>
Net insurance assessments	3,318,372
Income from U.S. Government securities	2,724,444
Other operating income (principally interest and allowable return from deposit insurance assumption and receivership cases)	<u>13,441</u>
Total income	<u>6,056,257</u>
EXPENSES AND LOSSES:	
Administrative and operating expenses	506,333
Deposit insurance losses and expenses	76,356
Interest paid to the Secretary of the Treasury on retired capital stock	<u>80,562</u>
Total expenses and losses	<u>663,251</u>
DEPOSIT INSURANCE FUND, NET INCOME ACCUMU- LATED SINCE INCEPTION	<u>\$5,393,006</u>

The notes following schedule 4 are an integral part of this statement.

The opinion of the General Accounting Office on these financial statements is set forth on page 16.

FEDERAL DEPOSIT INSURANCE CORPORATION

FOOTNOTES TO THE FINANCIAL STATEMENTS

JUNE 30, 1973

1. ACCOUNTING POLICIES

Securities--U.S. Government Securities are presented at amortized cost which is the purchase price of the securities less the amortized premium or plus the amortized discount. As of June 30, 1973, amortized premiums amounted to \$2,731,000 and amortized discounts \$19,974,000. Premiums and discounts are amortized on a straight-line basis from the month of acquisition to the month of maturity. For acquisitions occurring during the first 14 days of the month, the Corporation records amortization for the whole month. For acquisition after the 14th, amortization is recorded for a half month. Net income from U.S. Government Securities represents the total of interest income earned less premium plus discount amortization for the year.

Deposit insurance assessments--The Corporation assesses insured banks at the rate of 1/12 of 1 percent per year on the bank's average deposit liability less certain amortized exclusions and deductions. Assessments are due in advance for a 6-month period and credited to income when earned each month. Sixty-six and two-thirds percent of the Corporation's net assessment income for the prior calendar year is made available each July 1 to insured banks in the form of a pro rated credit against the current assessments due.

Depreciation--The office building is depreciated on a straight-line basis at the rate of 2 percent per year over a 50-year estimated life. Furniture, fixtures, and equipment are fully depreciated at the time of acquisition.

2. These statements do not include accountability for the assets and liabilities of the closed insured banks for which the Corporation acts as receiver or liquidating agent.

3. Legal actions pending against the Corporation on June 30, 1973, involved an estimated potential liability of \$88 million. In the opinion of the Corporation's General Counsel, these actions, arising essentially from litigation involving closed bank activities, may result in recoveries against the Corporation of \$9 million. This estimated loss has been provided for in these statements.

## GAO NOTE TO FINANCIAL STATEMENTS

On October 18, 1973, the U.S. National Bank of San Diego was closed and the Corporation was appointed receiver. On the same date, the Crocker National Bank of San Francisco assumed substantially all the deposit liabilities and purchased the acceptable assets of the closed bank. The following transactions relating to this deposit assumption, took place after June 30, 1973, and therefore are not accounted for in these financial statements.

1. The Corporation sold short-term and long-term U.S. Government securities of \$276 million to provide funds for the transactions. The Corporation sustained a loss of \$11 million on these sales.

2. Crocker National Bank paid the Corporation a purchase premium of \$89.5 million.

3. The Corporation, as receiver, purchased the U.S. National's unacceptable assets having a total book value of \$412 million. The Corporation paid the Crocker National Bank \$130 million, and paid the Federal Reserve Bank of San Francisco \$30 million as consideration for releasing assets pledged by U.S. National. The Corporation also assumed liabilities of \$117 million and the \$49 million capital account of the closed bank.

4. The Corporation purchased a \$50 million note from Crocker National Corporation to provide Crocker National Bank with additional capital.

The Corporation established a \$48.3 million reserve for loss in connection with this closing.



FEDERAL DEPOSIT INSURANCE CORPORATION, Washington, D C 20429

OFFICE OF THE CHAIRMAN

March 4, 1974

Mr. H. L. Krieger, Regional Manager  
U. S. General Accounting Office  
803 West Broad Street  
Falls Church, Virginia 22046

Dear Mr. Krieger:

This is in response to your letter of December 13, 1973, with which you enclosed two copies of your draft report to the Congress on the audit of this Corporation for the year ended June 30, 1973.

We appreciate this opportunity to review your draft and to offer certain comments.

As you know, the Corporation has indicated its views on several occasions in connection with your desire to have unrestricted access to bank examination reports and related documentation. In prior years, and particularly on February 9, 1973, in connection with your 1972 audit report, we have discussed the issues at considerable length. Inasmuch as our views on these matters have not changed, I should like to reiterate their substance by quoting from my letter of February 9, 1973, recognizing that certain of the figures have changed:

"As you are aware from past comments, however, we take issue with the repeated statements in the draft report that 'GAO was unable to discharge fully its audit responsibilities because the Corporation would not permit unrestricted access to examination reports, files and other records relative to the banks it insures.' We also take issue with the repeated statements that because of these restrictions, GAO was 'unable to ascertain (1) whether bank examinations were of sufficient scope and could be relied upon to identify all banks that should have been classified as problem banks, (2) whether the Corporation had taken effective follow-up action on findings disclosed by bank examiners, and (3) the significance of any possible adverse effect of problem banks on the financial position of the Corporation.'

"While the Corporation has consistently refused GAO's request in recent years for general access to reports of examination of open banks and to related material which would disclose the name of the bank involved, we do provide significant information to GAO about problem banks and other insured banks in accordance with the Memorandum of Understanding reached between our two agencies under date of December 13, 1950.

"This Memorandum of Understanding provides that FDIC furnish GAO's auditors each year with copies of recapitulations of serious problem banks and other problem banks, arranged by states and by totals, accompanied by a brief code analysis of the problems in each bank; that GAO's auditors could designate a number of such banks for selective review purposes; that FDIC, by code identification and without divulging the names of these banks, would discuss with GAO's auditors pertinent matters pertaining to the State nonmember banks included in the sample, including the relevant reports of examination and correspondence file; that FDIC would certify that the information given accurately reflected the confidential examination reports and file material related to such bank; that the same code identification given each bank reviewed would be continued until the bank was removed from the problem list; that similar information with respect to examination reports of open banks not classified as problem banks would be handled generally in the same manner; and that with regard to closed banks, GAO's auditors would have free access to all examination reports and related documents in our possession.

"The Corporation has scrupulously adhered to this Memorandum of Understanding over the years and has furnished to GAO's representatives all the information called for by its terms. We seriously doubt that our refusal to grant GAO general access to our reports of examination and correspondence files in such manner as to disclose the name of each bank reviewed has affected in any way GAO's ability 'to discharge fully its audit responsibilities' under the Federal Deposit Insurance Act or to make the findings referred to in the draft report. We continue to feel that the information contained in these reports of examination and related material must be regarded as confidential. We repeat our view, stated on numerous occasions in the past, that GAO's general access to this material, by name of bank, would be contrary to the public interest in the effective supervision of insured banks and the effective functioning of the Corporation's program of deposit insurance.

"The FDIC was created in 1933 to help restore and maintain public confidence in our banking system. In performing this function, the Corporation and all other supervisory agencies acquire and assess in their examination process a very large body of data about banks and bank management. By its nature, much of this information could not be obtained other than on a confidential basis for it is necessarily a mixture of fact, judgment, and personal opinion. If Federal and State supervisors of banks did not continue to treat most of the information in examination reports in strict confidence, sources of essential information would be denied them and effective bank supervision would be severely inhibited.

"In light of the detailed procedures established in our 1950 Memorandum of Understanding, we see no useful purpose to be served in providing GAO with

Mr. H. L. Krieger

March 4, 1974

a list of 'problem' banks by name. The fact is, and our experience over the years confirms the fact, that merely because an open bank is on our 'problem' list does not mean it is likely to fail or that expenditures from the Federal deposit insurance fund will be necessary. We maintain this list as an internal method of directing more intensive supervision to a relatively small number of banks which, for one reason or another, require it. Any bank so listed is an open, operating bank as to which neither its board of directors nor its chartering authority--the only persons which have the power to close a bank--has determined that its assets are worth less than its liabilities to depositors and other creditors. In almost all cases, the intensive supervisory attention given to banks on the list resolves the more serious problems these banks may have without the bank's failure. Put another way, it is our experience that the overwhelming percentage of banks which at one time or another appear on our 'problem' bank list are eventually removed from the list and continue to function as productive units in the nation's banking system. Your draft report points out, for example, that the Corporation listed 243 banks as 'problem' banks as of June 30, 1971, but that within the course of the fiscal year 128 insured banks were removed from the list because of improvements in bank management and/or financial condition, while 106 other banks were added to the list. Moreover, only two of the three banks which failed in fiscal 1972 were on our 'problem' list as of June 30, 1971, while none of the banks on our June 30, 1972 'problem' list has failed up to the date of this letter. These figures indicate, using only the most recent data, that the use by GAO of our 'problem' bank list as a guide to probable failure or as a basis to determine the extent of the Corporation's contingent liability would be distinctly in error.

"Banks on our 'problem' list are clearly vulnerable to a loss in public confidence that might lead to failure if their status, or the facts and judgments underlying it, become a matter of public discussion and knowledge. Had not this status and the relevant elements in it always been maintained in confidence, we believe a considerably greater number of open banks would have been forced to close over the years than was actually the case. While it is clear that our contingent liability for possible future expenditures from the Federal deposit insurance fund cannot be predetermined with regard to banks on our 'problem' list, any attempt to estimate such liability on the basis of a general review of examination reports and related material on all open banks would erode the fundamental concept of deposit insurance: that is, the maintenance of public confidence in our banking system. Probably the only fair guide GAO should use as to our contingent liability in the future is the frequency of actual bank failure in the past and the average disbursement of FDIC funds required because of such failures. This record, which is a tribute to the effectiveness of bank supervisory efforts at both Federal and State levels over the years, shows that in the last 30 years an average of only 3.5 insured banks out of almost

Mr. H. L. Krieger

March 4, 1974

14,000 in the country failed each year and that the annual disbursement from the Federal deposit insurance fund has averaged only \$13.1 million. Taking only the most recent ten years, an average of 5.1 insured banks have failed each year and the annual disbursement from the Federal deposit insurance fund has averaged \$33.4 million. Most of these disbursements, moreover, are recovered by the Corporation in the course of liquidating assets.

"We appreciate your position in this matter, but continue to believe that the full discharge of your audit responsibilities under the FDI Act does not require general access by GAO to reports of examination and related material in the FDIC's possession on all open banks or even as to a sample of all such banks by name. Were the scope of GAO's audit to be as broad as your draft report suggests it should be, the effective result would be to have GAO performing the functions of bank examiners and assuming the duties and responsibilities of the Board of Directors of the FDIC. We do not believe this to be the result Congress intended in defining GAO's audit responsibilities under the FDI Act."

Aside from this general re-statement of our position, it seems easiest to make specific comments in the order of your page sequence:

Page 1 (also on pages 2, 21, and 22): In the first sentence on page 1 under the heading "Opinion On Financial Statements" (and in some additional detail at the bottom of page 21 and on page 22), your draft notes that our financial statements do not show an estimate of the liability which the Corporation will incur because of future bank failures. It is our view that such estimates are impossible. At any point in time, it would be entirely coincidental if we had knowledge of future bank failures. Moreover, even if we felt that an individual bank might represent a potential future failure, it would be impossible for us to make accurate estimates of the Corporation's liability in such a case. Our eventual losses or contingent liability in such instances would depend upon factors which could not be assessed until or after a given bank actually failed.

On page 21, your draft repeats the earlier statement and then notes that "This policy is contrary to generally accepted accounting principles which advocate the matching of expenses to the periods during which the revenues are recognized." In that connection, we do not believe it to be good practice nor possible for us to carry on our books estimates of liabilities which may result from developments which have not occurred during the accounting period involved; or which may not happen at all in future accounting periods. Into the early 1960's, the letter accompanying your audit or a footnote to the audited financial statements contained the following statement: "The fund is not a measure of the deposit insurance risk. Its adequacy to meet future losses is dependent on future economic conditions which cannot be predicted."

Mr. H. L. Krieger

March 4, 1974

We believe a statement of that kind, in the context in which you used it, is accurate, defensible, and sound practice.

Page 3: Although we recognize the significance of the situation involving the U.S. National Bank of San Diego, we question whether your several references to the matter should occur in the body of your draft report on an audit for FY 1973. Additionally, the problem is so recent that only certain initial figures and facts can be stated with certainty. If you feel you should make some comment on the situation, even though it occurred after the close of FY 1973, we suggest that you might consider an addendum to your report which would include such relevant information as is now available.

[See GAO note, p. 29.]

Pages 4 and 5: For several years, based upon somewhat institutional views and prior interpretations, the Corporation has supported GAO's recommendation that the Federal Deposit Insurance Act be amended

[See GAO note, p. 29.]

[to] reimburse the employees' compensation fund for benefit payments made after the creation of the Corporation.

In the past year we have reviewed and researched these situations carefully. On the basis of discussions with individuals in GAO and in the Civil Service Commission

[See GAO note, p. 29.]

we have concluded that we can find a legal basis, notwithstanding earlier interpretations, for reimbursing the employees' compensation fund for benefit payments made after the creation of the Corporation and more recently. The latter conclusion will permit us to repay any compensation benefits which have inured to our employees and will also permit us to pay such costs in the future.

Mr. H. L. Krieger

March 4, 1974

[See GAO note, p. 29.]

Pages 18 and 19: Under the heading "Bank Failures", we note that you have incorporated a table showing the number of bank failures during 1969-1973. On the basis that your audit is concerned with FY 1973, we do not understand the need for a 5-year coverage of bank failures. Accordingly, we suggest the relevant information, for the purposes of this report, should outline the situation with respect to banks which failed during FY 1973.

[See GAO note, p. 29.]

Mr. H. L. Krieger

March 4, 1974

[See GAO note.]

Pages 21 and 22: In connection with the section entitled "Estimated liability for future bank closings", please note our comments on the same subject with respect to pages 1 and 2.

[See GAO note.]

Pages 26 and 27: In connection with the last sentence, please refer to our earlier comment on the phrase "...except for the foregoing comments regarding the estimated liability for future bank failures, . . . ."

[See GAO note.]

We trust these suggestions will be useful as you complete your audit report. Because of the editorial difficulties inherent in this kind of response, we would be glad to discuss any problems you may have. If you feel such discussion would be helpful, please communicate with Mr. Edward F. Phelps, Jr., Controller, at 389-4481.

Sincerely,



Frank Wille  
Chairman

**GAO note:** Deleted comments relate to matters which were presented in the draft report but which have been revised or omitted from this final report.

Page numbers refer to pages of draft report.

APPENDIX II

MEMBERSHIP OF THE BOARD OF DIRECTORS

	<u>Tenure of office</u>	
	<u>From</u>	<u>To</u>
Frank Wille, Chairman	Mar. 1970	Present.
James E. Smith, Comptroller of the Currency (note a)	July 1973	Present
George A. LeMaistre (note b)	Aug. 1973	Present

<sup>a</sup>William B. Camp served in this capacity from November 1966 until he retired in March 1973. Justin T. Watson then became the Acting Comptroller through July 1973, when Mr. Smith was appointed.

<sup>b</sup>Irvine H. Sprague served on the Board of Directors from September 1968 until he resigned in February 1973. His resignation left a vacancy on the board through August 1973 when Mr. LeMaistre was appointed.